Sustained Macroeconomic Stability

- In six years, Serbia has transformed to a low inflation and stable growing economy, with a balanced fiscal position, declining public debt, significantly reduced external imbalances and labour market recovery, which helped our economy to respond readily to ongoing challenges.

- COVID-19 and global recession will have a less severe impact than in other European countries, due to achieved macro stability, growth momentum, fiscal space created in previous years, large and timely monetary and fiscal package, and favourable structure of the economy.

- Inflation has moved in accordance with our expectations, and in July it measured 2.0% y/y. Low inflationary pressures are also confirmed by the core inflation of 1.7%, as well as by stable inflation expectations. Inflation is expected to average 1.7% and 1.6% in 2020 and 2021, respectively.

- GDP growth in 2019 continued with strong economic expansion reaching a rate of 4.2%, driven by investments. The trend continued in Q1 2020 with growth of 5% y/y, despite first effects of COVID-19. Pandemic effect on the economy peaked in Q2, but the recorded GDP decline of 6.5% y/y was one the smallest in Europe, due to sizeable, timely and comprehensive monetary and fiscal support package.

- On the back of Q2 results and expected recovery by the end of the year, we kept the projected annual growth at -1.5% for 2020 and +6% for 2021.

- The adopted economic measures (EUR 5.8 bn, around 12.2% of GDP) should allow GDP to return to pre-crisis levels by the end of the year and sustainable growth of around 4% in the medium term. In May, Government issued a 7Y Eurobond of EUR 2 bn, at an interest rate of 3.375% (coupon rate 3.125%), but the level of public debt will most likely remain below Maastricht criteria of 60% of GDP.

- External imbalances will be reduced this year with CAD is set to decline to around 5% of GDP. On the other hand, macroeconomic stability and improved business environment that led to high FDI inflows of EUR 7.3 bn in 2018–19, enabled FDI inflow to continue even in H1 2020 (6.7% of GDP, EUR 1.5 bn).

- Unemployment rate reached the lowest level in 2019 while employment rate reached the highest comparable level.

- Results were acknowledged by confirmed credit ratings in 2020 (Fitch and S&P) despite global crisis caused by COVID-19 pandemic. In 2018, a PCI arrangement with the IMF has been approved, with successfully completed 3rd review.

- In August, NBS decided to keep the key policy rate unchanged at the level of 1.25%.

- Banking sector stability has been preserved and further reinforced. Encouraged by the NBS measures, the share of NPLs in total loans declined to 3.7% at end-June 2020. Capital adequacy indicators are even stronger after the application of Basel III standards in Serbia.
Inflation Returned Within the Target Tolerance Band; Inflationary Pressures Remain Low

Inflation profile similar to advanced economies…

• Inflation is kept firmly in check, moving around 2% on average in the past six years.

• After low level in April and May, inflation returned within the target band in June and measured 2.0 y/y in July.

• Inflation movement since the beginning of 2020 was a result of fruit and vegetables prices as well as oil derivatives prices.

• The biggest positive contribution to inflation came from services prices (0.8 pp) processed food prices (0.7 pp) prices of fruits (0.6 pp) and cigarettes (0.4 pp).

• The biggest negative contribution came from prices of oil derivatives (-0.8 pp)

… same stands for core inflation

• Average core inflation in the last six years stood at 1.4%, confirming price stability.

• Core inflation stood at 1.7% y/y in July. Its growth since the beginning of the year has been driven by a one-off price increase of telephone services and travel packages.

• According to Bloomberg’s August survey, one year ahead inflation expectations of the financial sector are 2.0% (July 1.7%).
Inflation Stable Within the Target in the Medium Term

Inflation will hover around the lower bound of the target tolerance band in the period ahead…

…and will gradually approach the target midpoint from the 2022

- Inflation has returned within the tolerance band in the mid-2020, and will hover around the lower bound of the target tolerance band until the end of 2021, gradually approaching the target midpoint thereafter.

- Risks of the projection are judged to be symmetrical and related mainly with trends in the international environment, primarily global trade and economic growth, capital flows to emerging economies and the global prices of oil and other primary commodities.

- The movement of inflation will also depend on the pace of recovery of domestic demand and administered prices.

- In the short run, inflation will stay around the current level driven by the low base effect from vegetable prices form one side, and still depressed petroleum product prices on the other side.

- Disinflationary pressures, that prevail in the medium run, will come from low domestic and external demand, as well as low import inflation, while the disinflation effect from the oil prices drop in the previous period will gradually wane.
GDP Decline of 6.5% y/y in Q2, Among the Smallest in Europe

Contraction in all sectors due to temporary lockdown and precautionary measures was smaller than expected

Lesser than expected decline in private consumption and investments

- After strong GDP growth in Q1 (5.0% y/y), economic activity declined by 6.5% in Q2, due to negative effect of COVID-19 pandemic and nationwide lockdown.
- The decline was lesser than expected, and among the smallest in Europe, owning to good pre crisis fundamentals as well as promptly introduced economic measures for private sector support.
- According to our estimation, the decline was driven mainly by the decrease in industrial production and services, followed by the fall in net taxes.
- The lockdown introduced in many countries led to decrease in production and trade, and subsequently to decline in inventories. On the other hand, faster decrease in imports than exports led to estimated positive contribution of net exports.
- Private consumption also declined, but less than expected, supported by the economic measures.
- Government consumption on the other hand increased in double digits due to large expenditures for medical equipment and increase in medical staff wages.
- If the pandemic situation stabilizes, the V shape recovery is expected in the following quarters.
Minimal GDP Decline of 1.5% in 2020, Followed by Growth of Around 6% in 2021

Decline caused by temporary investment contraction, fully compensated for in 2021

In the coming years Serbia will maintain a strong, sustainable and broad-based growth

Chart 7 GDP developments
(y/y growth rates in % and contributions in pp)

Chart 8 GDP growth projection (from August 2020 IR)
(y/y growth rates, in %)

- The crisis caused by COVID-19 pandemic pushed the projection of economic growth down to -1.5% in 2020, but it will not cause long term GDP contraction. Full recovery is expected in 2021 with growth of 6.0%.
- The decline will primarily be driven by the temporary fall in investment, but on the other hand we expect positive contribution form government consumption and net exports, due to larger decline in imports than exports.
- Personal consumption is projected to decline, but only slightly, due to support measures aimed at preserving private sector companies and the labor market.
- We estimate the risks to our projection as symmetric.
- The risks coming form international environment related to pandemic situation and the pace of the Eurozone recovery are assessed as asymmetrical to the downside.
- On the other hand, risks related to domestic factors are tilted to the upside. These reflect continuous systematic improvement of business environment which enables further growth of investment and industrial production. Also preserved jobs during the lockdown, higher disposable income and favorable financing conditions mitigated negative effect of pandemic on consumption and service sectors activity.
### Table 1. Programme of Economic Measures to Mitigate the Negative Effects Caused by the COVID-19 Pandemic and Support the Serbian Economy

<table>
<thead>
<tr>
<th>Group</th>
<th>Measures</th>
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| **I Group – Tax policy measures** | 1. Deferred payment of payroll taxes and contributions in the private sector (during the state of emergency) with subsequent repayment of liabilities in instalments (starting from 2021 at the earliest)  
2. Deferred payment on taxes and contributions on salaries for one month  
3. Exemption of donors from the obligation to pay VAT |
| **II Group – Direct assistance to the private sector** | 4. Payment of three minimum wages to entrepreneurs that are subject to the flat rate tax and pay tax on actual income, and to micro-, small- and medium-sized enterprises in the private sector  
5. Payment of assistance to large private sector enterprises in the amount of 50% of net minimum wage for employees on paid temporary leave on employer’s decision |
| **III Group – Measures to preserve liquidity** | 6. Financial support to the corporate sector through the Development Fund  
7. Corporate support guarantee scheme  
8. Additional NBS liquidity support |
| **IV Group – Other measures** | 9. Moratorium on dividend payments until the end of 2020, except for public enterprises  
10. Moratorium on loans for 3 months proclaimed by NBS  
11. Direct assistance to all adult Serbian citizens in the dinar equivalent of EUR 100 |
| **V Group – Additional package of measures (July/August 2020)** | 1. Payment of 60% of minimal wages to entrepreneurs, and to micro-, small- and medium-sized enterprises in the private sector  
2. Deferred payment of income tax advances for one month  
3. Additional NBS two months moratorium on loans |

Source: Ministry of Finance.
The Ongoing Investment Cycle

Preceded by achieved macroeconomic stability, new investment cycle began in 2015…

• In 2015-2019, fixed investments grew at an average annual rate of about 10%, while their cumulative growth was about 63%.
• The fastest growth was made in 2018 and 2019, when fixed investments increased in real terms by 17.8% and 16.4%.
• The share of fixed investment in real GDP increased from 17.5% in 2014 to 24.3% in 2019, and it is expected to continue to rise, with a temporary crunch in 2020 due to negative effects of the Covid-19 pandemic.

…supported by diversified financing sources

• In earlier years, investments have largely relied on FDI.
• Owing to maintained macroeconomic and financial stability, exchange rate stability, as well as fiscal consolidation, in recent years we gained three more strong pillars for financing investments: multiplied profitability of the economy, investment credits and doubled government investments.
• On top of that, FDI inflow reached record levels of around 8% of GDP.
Macroeconomic and Financial Stability
Supported High FDI Inflow

Macroeconomic and financial stability combined with structural reforms has created a favourable climate for FDIs...

...which are diversified by sector and origin and contributing to the country’s export potential

- Out of a gross inflow of EUR 7.3 bn (EUR 6.7bn net) in 2018 and 2019, EUR 4.1 bn has been directed into tradable sectors, most notably manufacturing (EUR 1.9 bn).
- Manufacturing sectors with the highest FDI inflows (metals, autos, food, tyres) recorded a high growth in employment, output and exports.
- During H1 2020 FDI remained robust despite the corona virus pandemic, with net inflows of EUR 1.5 bn (6.7% of GDP).

- FDI inflows are diversified by region of origin as well, with a greater share of countries from the Asia Pacific and Middle East regions, alongside Serbia’s major investment partner - the European Union.
- During 2017 – 2019, the bulk of FDI inflows still came from Euro area countries (45.1%), but with an increasing share of Asian countries (16.4%) such as China/HK and the UAE, as well as non-EU European countries (20.8%) such as Russia, Turkey and Switzerland.
Current Account Deficit Set to Decline to 5.0% of GDP in 2020

CAD peaked in 2019 due to high growth in equipment imports

Key factors behind CAD improvement in 2020 are a contraction in domestic demand, lower oil prices and resilience of exports on account of their structure, diversification and investment in exporting industries in the previous period.

- In H1 2020 CAD amounted to EUR 1.3bn, down by 11.0% from a year earlier.
- The CAD amounted to 6.9% of GDP in 2019, as a result of an increase in the share of investment in GDP.
- Since 2015 Serbia’s current account deficit has been fully financed by net FDI, which we expect to be continued in the coming period.

From a savings-investments perspective CAD increase in 2019 was driven by higher investments

- In 2020 the decline in the S-I gap will be driven by a faster reduction of private and public investments (postponement of projects) than in public sector savings.
- Private sector savings will increase in 2020 due to reduced domestic demand and lower energy prices.
- During 2019 the share of gross domestic investments in GDP increased from 22.7% to 24.6% broadly in line with the CAD increase.
- The S-I gap since 2017 is driven by the private sector, while government savings and investments were mainly neutral (a result of the fiscal consolidation) until the pandemic.
Exports are Expected to Rebound Strongly

Exports will decline slightly in 2020 due to global recession, with return to previous growth path already in 2021

Imports decline will be deeper and recovery slower due to combined effect of domestic demand and energy prices

- Small decline in overall exports of goods and services in 2020 will be driven by decrease manufacturing exports due to reduced external demand and disruption in global value chains.
- Services exports are expected to show more resilience due to limited share of tourism and high pre-crisis growth of less affected sectors – IT and business services.
- After contraction in Mar/Apr (-36% s-a cumulative), recovery of goods exports started in May/Jun (+27% s-a cumulative), driven by a rebound in exports of manufactured goods (+29.3% s-a) - in particular automobile components, machinery and metals.
- The greatest reduction in imports in 2020 is expected in energy and other industrial inputs due to price decline and reduced overall economic activity, as well as in services.
- Oil price decline in will have a delayed additional effect on lower natural gas prices throughout 2021.
- As of 2017 Serbia saw a faster growth in imports on account of capital and intermediate goods related to investment and industrial activity as well as growth in domestic demand.
- After falling 38% s-a in Mar/Apr, goods imports also increased in May/Jun (+24% s-a) driven mainly by intermediate and capital goods.
Foreign Trade Dynamics Determined by the Pandemic

Expected decline of exports in H1 2020 due to decreased external demand

Chart 17 Goods exports by country in H1 2019/ H1 2020
(EUR mn and % of total)

• Serbia’s exports are largely directed towards EU and countries of the region, and reliant on demand in those countries which is currently lacking. In H1 2020, most of Serbian exports went to the EU, followed by CEFTA and CIS.

• By country, the largest share of exports went to Germany (12.8%), followed by Italy (8.4%), Bosnia and Herzegovina (7.3%), Romania (6.2%) and Russia (5.2%).

• In H1 2020 compared to H1 2019, the total volume of exports has decreased in all top 10 countries.

• Unlike the top 10 countries, exports to China continued to grow in H1 2020 compared to H1 2019.

China catches up to Germany in H1 2020 as the most important import partner

Chart 18 Goods imports by country in H1 2019/ H1 2020
(EUR mn and % of total)

• Majority of imports (around 58%) come from the EU, followed by CIS and CEFTA.

• By country, the largest shares of imports are from Germany (13.1%), whereas the share of imports from China increased from 8.6% in H1 2019 to 11.8% in H1 2020, mostly due to imports of medical equipment. Following Germany and China, third is Russia (8.3%) and then Italy (8.1%).
The unemployment rate kept at single-digit levels in Q1 2020

Chart 19 Labour market indicators according to the Labour Force Survey, (in %)

- The unemployment rate in Q1 2020 was 9.7%, unchanged compared to Q4 2019 and kept at a single-digit level, while y/y decreased by 2.4 percentage points.
- The employment rate was at the level of 48.7%, which represents y/y growth of 1.4 p.p. and it is mostly led by employment in private sector, with a reduction in informal employment.
- The increase in the number of employees also comes from a higher participation rate of 0.4 p.p. at y/y level, which in Q1 2020 was 67.6%.

Increasing contribution of total factor productivity to Serbian GDP growth

Chart 20 Contribution of factors of production to GDP (in pp, period average)

- In the period as of 2015, a positive contribution to GDP growth came from capital, labour and TFP.
- Growth acceleration in 2017-2018 was driven mainly by faster TFP growth. Labour contribution to growth declined compared to 2015-2016, compensated by a faster growth of the capital stock.
- In the medium term, we expect still lower contribution from labour, a higher capital contribution due to structural reforms, while TFP contribution will increase further to 2 pp supporting income convergence to developed countries.
Favourable Labour Market Developments and Productivity Growth

The average wage in the period January - May 2020 was above 500 euros

- The average net wage for January-May 2020 amounted to 59,116 dinars (503 euros) and slightly slowed down the y/y growth to 9.0% (from 9.6% for the period January-April).
- The slowdown was noticeable both in the private (8.5% y/y) and in the public sector (10.6% y/y) in the same period.
- Wage growth continued at a relatively high growth rate despite a serious slowdown in economic activity in Q2, owing to comprehensive economic measures.
- The largest growth since the beginning of 2020 was recorded in the manufacturing and construction, as well as in private sector services.

Dominant contribution of industry in formal employment

- Total formal employment in the first half of 2020, despite the pandemic and thanks to state measures, only slightly slowed growth to 1.7% y/y (from 2.0% in 2019). This trend is a result of the growth of employment in the private sector by 2.3% y/y (about 36 thousand persons), but also in the public sector in H1 a slightly higher number of employees was recorded (for over 1 thousand persons, primarily in the health sector).
- Observed by activities, during H1 2020 employment in construction and manufacturing increased the most, as well as in services of the predominantly private sector.
Increase in Fiscal Deficit in 2020 Due to Covid-19, Public Debt Below 60% of GDP at the End of the Year

High fiscal deficit in H1 as result of support measures should decrease in H2

- After two years of surplus, fiscal balance recorded deficit of 0.2% of GDP in 2019 as a result of intensive government investment, which grew by one third, reaching near 5% of GDP.
- Higher deficit in H1 2020 is a result of lower tax indirect revenue, direct tax relief and double digit increase in expenditures, particularly for support measures to private sector companies, as well as medical equipment in light of the pandemic.
- Increased spending will continue in Q3 due to second package of stimulus measures, but fiscal deficit is projected to stay between 8% and 9% of GDP for the whole year.

Increasing public debt, but still sustainable and below the Maastricht level

- In the H1 public debt increased to 57.3% of GDP (from 52.0% at the end of 2019), mainly due to a 7y Eurobond of EUR 2 bn, issued in May, at a rate of 3.375% (coupon rate of 3.125%).
- The funds are used for the Government program for mitigation of negative effects of coronavirus. However, public debt is projected to remain below the Maastricht criteria level of 60%.
- Public debt dinarisation picked up from 20.9% (end-2016) to 28.4% in June 2020.
- In the medium-term deficit will return to the level of around 0.5% of GDP.
Key Policy Rate Kept Unchanged at 1.25%, at Lowest Level in the Inflation Targeting Regime

In August 2020, the key policy rate is kept on hold at 1.25%

FX required reserve ratio has remained unchanged since early 2016

The decision takes into account the following factors:

- the achieved and expected effects of monetary policy measures taken to mitigate the fallout from the pandemic and to bolster economic growth,

- high degree of uncertainty in the international commodity and financial market - primarily regarding to the global course of the pandemic and the pace of recovery of the global economy going forward, as well as of the movement of prices of primary commodities, above all the oil price.

- Last time FX RR ratio was cut in 2016 aiming to support lending activity (to 20%/13%, for liabilities up to over 2Y).

- RR is an important monetary policy tool (in June 2020 RR amounted to EUR 2.2 bn and RSD 211.5 bn).

- NBS uses RR as an important macroprudential tool within dinarisation strategy:
  - by applying lower RR ratio on dinar vs FX sources,
  - by applying remuneration on dinar RR (i.e. on RSD RR „standard“ rate 0.10% and „special“ rate of 0.60% under predefined conditions, on amount on dinar lending in line with State Loan Guarantee Scheme), while no remuneration is applied on FX RR.
The Effects of Monetary Policy Easing are Reflected in Lower Costs of Government and Private Sector Financing...

Interest rates on dinar government securities are moving around their minimum levels...

- The dinar yield rate curve is extended up to 12 years in February, with great interest of investors for this kind of bond.

- The share of long-term securities (5+ year maturity), increased from 2% in December 2012 to over 75% in 2020.

- In auction held in January 2020, Serbia issued for the first time EUR bond with the maturity of 20 years (with yield rate of 3.0%).

... as well as interest rates on private sector loans

- Since the beginning of monetary policy relaxation cycle (May 2013),** dinar lending interest rates** fell sharply, which in June amounted to:
  - 3.4% for corporates (down by 13.1 pp)
  - 8.0% for households (down by 12.5 pp)

- The servicing costs of outstanding credit amounts have also been reduced, leading to higher disposable income for consumption and investments, of both households and corporates.

- In the observed period, a sharp fall in the country risk premium and the country’s credit rating upgrade, as well as monetary easing by the ECB contributed to the fall in EUR-indexed lending rates.
Lower costs of financing support domestic lending …

... as well as to Growth of Credit Activity

- In 2020, **domestic lending** continued up at two-digit y-o-y growth rates, which in June accelerated to 13.9%.
- The credit growth structure remained favourable in terms of the contribution to economic growth, led by corporate and households loans.
- Further growth of lending activity is expected in the coming period, as a result effects of undertaken measures and monetary policy easing by the NBS, low interest rates in the euro area, disbursement of Guarantee Scheme loans, interbank competition and reduced NPLs.

... and the positive tendencies are also reflected in corporate loans market

- Corporate loans are providing the biggest contribution to y/y growth rate of total credit activity for more than a year (in June almost 60%) and significant support to further growth of economic activity.
- The biggest impetus to the y/y growth rate of corporate loans (15.9% in June 2020) are providing the investments and liquidity and current assets loans.
- Investments loans have become the largest category of corporate loans in May 2019, while their share in total corporate loans amounted to 44.4% in June 2020), followed by loans used to finance current assets (with share of 40.7% in June 2020).
Despite Global Uncertainty and Increased Risk Aversion Dinar Stayed Broadly Unchanged

Unprecedented economic stimulus around the world contributed to the fall in EM risk premia

Chart 31 EMBI risk premium
(basis points, daily values)

*Until August 12, 2020

- After Serbia’s risk premium reached its historical low in December, and recorded the biggest fall in the region in 2019, corona virus pandemic and increased uncertainty in international financial market caused the substantial rise in the risk premia of emerging markets in March 2020, including Serbia. Subsequent fiscal and monetary stimulus around the world, helped mitigate the global uncertainty and contributed to the fall in EM risk premia. EMBI for Serbia is far below EMBI Global Composite and has recorded the biggest fall in the region since the beginning of May.

- Both Fitch (March) and S&P (May and June) have affirmed Serbia’s rating at BB+, despite global crisis caused by COVID-19 pandemic, emphasizing increased resilience of Serbia comparing to previous crisis.

The dinar maintained relative stability against the euro

Chart 32 Exchange rate developments
(31 December 2012 = 100)

* + net purchase; - net sale.
** EUR 1 in RSD.

- In the previous three years the dinar cumulatively appreciated by 5% against the euro in nominal terms. Strengthening of the dinar was stimulated by better Serbia’s macroeconomic fundamentals, good performance and favorable growth prospects, which contributed to FX inflow of FDI and elevated non-resident investment in long-term dinar government securities, resulted in bolstering the FX reserves.

- Since the beginning of 2020, the dinar stayed broadly unchanged against the euro, despite the rise in global uncertainty, as NBS has provided needed FX liquidity to banks in circumstances of lower FX supply.
Indicators of Dinarisation are on the Rise

Macroeconomic stability contributing to dinarisation process

The growth of dinar loans to households accompanied by higher dinar savings

- NBS stimulates the dinarisation process by delivering low and stable inflation, preserving relative exchange rate stability, enhancing management of FX risks and exposures in the private sector, and using other measures.
- The Government contributes to dinarisation through tax policy, by developing the dinar securities market (dinar debt share rose from 2.5% in 2008 to 28.4% in June 2020).
- Dinarisation of corporate and household sector deposits rose by 19.2 pp compared to end-2012 and currently stands at 38.5% (June 2020) – its highest level so far. Dinarisation of corporate and household sector receivables also reached its maximum level of 34.6% in June (up by 6.5 pp compared to end-2012).
- Over the past years, dinarisation of household receivables had a firm upward trend as a result of a sharp drop in dinar interest rates, low and stable inflation as well as NBS measures aimed to support dinarisation – an upsurge from 35.1% (2012) to 55.8% (June 2020).
- Dinar savings of households (residents) recorded strong growth in past two years (22.2% in 2018 and 30.7% in 2019), which is also continued in 2020 (in six months it increased by RSD 6.0 bn).
- Such savings trends testify to the household confidence in the banking system and the domestic currency, which gains particular importance amid the rising uncertainty fuelled by the pandemic.
Traditional Banking
Mostly Financed by Domestic Deposits

**Adequate structure of banking sector assets**

- Risk aversion during the crisis led to more intensive investments in low-risk state securities, which after 2015 stabilized at around 45% of the total banking sector net assets (16.3% at the end of June 2020).
- Despite historical low levels of deposit rates, stability of retail and corporate deposits in funding mix is present, with share in total liabilities of 45% and 29%, respectively at the end of June 2020.
- Despite high loan portfolio euroization, currency matching of assets and liabilities is present, with net open position of 0.9% of regulatory capital at end of June 2020.

**Improving the quality of the banking sector assets**

- Implementation of NPLs resolution measures together with the growth of credit activity led to a significant improvement of banks portfolio quality. The share of NPLs decreased to the lowest level since the 2008 when the definition and reporting requirements were introduced.
- At end-June 2020, the NPL ratio was 3.7%, with the maintenance of relatively high coverage by both, IFRS provisions (62.6%).
- The main channels for the NPLs reduction remained the write-off and transfer (sale) to third parties, with increasing contribution of repayment.
Conservative Framework Contributed to the Banking Sector Resilience to Shocks

High banking sector capitalisation as a result of strong prudential measures

- Banks possess significant capital reserves, which enable them to successfully deal with credit risk even in the case of worst-case stress scenario.
- In addition to the high level, the capitalization of the banking sector is characterized by a strong structure, with CET1 around 95% of total capital.
- The high solvency of the banking sector is also indicated by the leverage ratio, introduced in regulatory framework of the Republic of Serbia with Basel III implementation, which at the end of June 2020 amounted to 12.9%.

Serbian banking sector is highly liquid

- Liquidity ratios are constantly at levels significantly higher than the regulatory minimum.
- Liquid assets account for around 36.5% of the total assets of the banking sector in June 2020.
- The loan to deposit ratio that at the end of June 2020 amounted 89.2%, indicates stability of funding and in general the liquidity of the banking sector.
Structural slides
Improved Structural Competitiveness Provided Additional Boost to Overall Macroeconomic Performance

**Key reform areas in the last four years:**

- Construction sector;
- Labor market;
- Tax administration;
- Financial sector;
- Contract enforcement and resolving insolvency.

Chart 39 **Indicators on business regulation, Doing Business**
(rank, lower value means rank improvement)

- Starting a business
- Dealing with construction permits
- Getting electricity
- Registering property
- Getting credit
- Paying taxes
- Protecting minority investors
- Resolving insolvency
- Enforcing contracts
- Trading across borders
- Overall rank


Chart 40 **Global competitiveness indicators, WEF**
(rank, lower value means rank improvement)

- Overall ranking
- Institutions
- Infrastructure
- Macroeconomic environment
- Health
- Skills
- Commodity market efficiency
- Labour market efficiency
- Financial market development
- Technological competence
- Business dynamics
- Market size
- Innovation
- Inovations
- Overall ranking

Source: *World Economic Forum*. 

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24
Legal Framework for Banking Supervision

- **Domestic regulatory framework for banking supervision is based on Basel III standards:**
  - Set of by-laws implementing these standards on individual and consolidated level are applied as of 30 June 2017;
  - Since July 2017 further steps on harmonization of domestic legal framework with Basel III were made;
  - The main goals of implementing these standards are to increase the resilience of the banking sector by enhancing the quality of capital and introducing capital buffers, to increase the efficiency of monitoring and controlling banks’ exposure to liquidity risk, further strengthening of the market discipline and transparency of banks’ operation in the Republic of Serbia by publishing all relevant information on bank operation, as well as to bring the reporting system in line with the new regulatory arrangements
  - So far no issues have been identified in the application of Basel III standards;
  - NBS will continue to take regulatory activities in order to ensure alignment with EU acquis.

- In December 2017 **regulation governing risk management by banks was amended** with aim to improve the way bank deals with risks and enhance its Internal Capital Adequacy Assessment Process (ICAAP).

- Accounting and prudential regulations were timely adjusted in order to **enable the implementation of IFRS 9 in banks from 1st of January 2018.**

- Additionally, cooperation with supervisors of the home countries of banks present in Serbia is continuously developing and strengthening and regular communication with the ECB and EBA is maintained.
The Amendment of NPL Resolution Strategy by adoption of NPL Program for period 2018 - 2020

Effect of strategy on NPL stock

Effect of strategy on NPL ratio

- Aggregate decrease of NPL level in August 2015 – February 2020 amounts to RSD 327.0 bn, while the effect of the NPL Strategy is mostly reflected through the historically lowest level of NPL ratio of 3.7% at end-June 2020. Compared with NPL ratio before the NPL Strategy entered into the force (22.25%) the decrease is clearly impressive at 18.51 p.p.

- Beside successful implementation of NPL Strategy, it is necessary to perform activities intended for resolution of remaining problems in order to provide the sustainability of achieved results. For that purpose, it is very important to create the ambient, which strives for early detection of sources and causes of NPLs, as well as, upgrading of existing institutes directed toward resolution of potentially new NPLs. Bearing that in mind, the Government of the Republic of Serbia on the December 27th 2018 implemented a Program for NPL resolution for period of 2018 – 2020 (Program for NPL).

- As a integral part of Program for NPL, Action plan focuses on subjects of:
  - resolution of non-performing claims of state-owned financial creditors, through assignment of claims and eventually write-off of remaining part of portfolio;
  - improving bankruptcy framework, i.e. it`s upgrade as institute in non-performing claims resolution;
  - series of activities that are directed to the prevention of emerging and accumulating of new NPLs.
Capital Buffers – Implementation of Macroprudential Policy Measures

- Capital buffers increase the resilience of banks to losses, reduce excessive or underestimated exposures and restrict the distribution of capital.
- These macroprudential instruments should limit systemic risks in the financial system, which can be cyclical (capital conservation buffer and countercyclical capital buffer) or structural (capital buffer for a systemically important bank and systemic risk buffer).
- The following capital buffers are used in the Republic of Serbia:
  - Capital conservation buffer;
  - Countercyclical capital buffer, in order to mitigate and prevent excessive credit growth;
  - Capital buffer for a systemically important bank, with the objective to limit the systemic impact of misaligned incentives in terms of favoring certain financial institutions;
  - Systemic risk buffer, introduced to limit the risk of euroisation, one of the key structural non-cyclical systemic risks to the stability of the financial system of the Republic of Serbia.
- The capital conservation buffers may consist only of Common Equity Tier 1 capital equal to 2.5% risk-weighted assets for capital conservation buffer, 1% or 2% risk-weighted assets for capital buffer for systemically important banks, depending on the systemic importance level and 3% of total foreign currency and foreign currency-indexed placements of a bank approved to corporates and households in the Republic of Serbia for systemic risk buffer. Countercyclical buffer rate is set at 0%.
- Capital buffers apply as of 30 June 2017.
NPL Resolution Required a Systemic Approach – and, as Such, Gave Results

- NPL development after the adoption of the NPL Resolution Strategy, especially in 2017, 2018 and 2019, confirmed the soundness of the inter-institutional and coordinated approach envisaged by the Strategy.

- After 2019 drop in share of NPLs of 1.61 pp, noticeable downward trend had slow downed in 2020, resulting with four times lower NPL ratio than it was at the time of Strategy adoption.

- Fall was widespread and recorded in all sectors, of which most prominent was within construction.

- The continuation of NPL resolution efforts by banks together with the recovery of credit activity, should further stimulate the decrease in the share of NPLs.

### NPL data, June 2020

<table>
<thead>
<tr>
<th></th>
<th>Gross loans (EUR bn)</th>
<th>Gross NPL (EUR bn)</th>
<th>NPL ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporates</td>
<td>10.1</td>
<td>0.3</td>
<td>3.1</td>
</tr>
<tr>
<td>Natural persons</td>
<td>10.0</td>
<td>0.4</td>
<td>3.8</td>
</tr>
<tr>
<td>of which: households</td>
<td>9.0</td>
<td>0.3</td>
<td>3.8</td>
</tr>
<tr>
<td>Corporates in bankruptcy proceedings</td>
<td>0.1</td>
<td>0.1</td>
<td>98.5</td>
</tr>
<tr>
<td>Other</td>
<td>2.6</td>
<td>0.1</td>
<td>3.8</td>
</tr>
<tr>
<td>Total</td>
<td>22.8</td>
<td>0.9</td>
<td>3.7</td>
</tr>
</tbody>
</table>
## Serbia’s Economic Outlook

### Serbia

<table>
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<tr>
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</thead>
<tbody>
<tr>
<td><strong>Real GDP, y-o-y %</strong></td>
<td>5.7</td>
<td>-2.7</td>
<td>0.7</td>
<td>2.0</td>
<td>-0.7</td>
<td>2.9</td>
<td>-1.6</td>
<td>1.8</td>
<td>3.3</td>
<td>2.0</td>
<td>4.4</td>
<td>4.2</td>
<td>-1.5</td>
<td>6.0</td>
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<tr>
<td><strong>Private consumption, in %</strong></td>
<td>4.5</td>
<td>-3.3</td>
<td>-0.6</td>
<td>1.4</td>
<td>-1.7</td>
<td>-1.7</td>
<td>-0.1</td>
<td>-0.3</td>
<td>1.3</td>
<td>1.9</td>
<td>3.1</td>
<td>3.2</td>
<td>-0.5</td>
<td>5.1</td>
</tr>
<tr>
<td><strong>Private investment,¹ in %</strong></td>
<td>14.4</td>
<td>-23.6</td>
<td>-7.9</td>
<td>7.5</td>
<td>15.1</td>
<td>-7.7</td>
<td>-5.6</td>
<td>3.5</td>
<td>2.7</td>
<td>10.1</td>
<td>13.6</td>
<td>13.4</td>
<td>-11.0</td>
<td>10.2</td>
</tr>
<tr>
<td><strong>Government consumption, in %</strong></td>
<td>3.5</td>
<td>-1.7</td>
<td>0.0</td>
<td>1.6</td>
<td>0.4</td>
<td>-2.1</td>
<td>0.9</td>
<td>-3.8</td>
<td>1.3</td>
<td>3.3</td>
<td>3.7</td>
<td>3.0</td>
<td>6.0</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>Government investment, in %</strong></td>
<td>-16.4</td>
<td>-16.6</td>
<td>0.0</td>
<td>-7.8</td>
<td>7.6</td>
<td>-35.8</td>
<td>13.6</td>
<td>14.0</td>
<td>22.0</td>
<td>-6.4</td>
<td>43.1</td>
<td>30.4</td>
<td>-8.5</td>
<td>26.6</td>
</tr>
<tr>
<td><strong>Exports, in %</strong></td>
<td>12.6</td>
<td>-11.5</td>
<td>16.9</td>
<td>5.6</td>
<td>2.9</td>
<td>18.0</td>
<td>4.3</td>
<td>9.4</td>
<td>11.9</td>
<td>8.2</td>
<td>8.3</td>
<td>8.5</td>
<td>-6.6</td>
<td>16.4</td>
</tr>
<tr>
<td><strong>Imports, in %</strong></td>
<td>10.1</td>
<td>-21.9</td>
<td>-0.1</td>
<td>7.2</td>
<td>-0.6</td>
<td>6.5</td>
<td>5.1</td>
<td>4.0</td>
<td>6.7</td>
<td>11.1</td>
<td>11.6</td>
<td>9.5</td>
<td>-6.9</td>
<td>15.8</td>
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<tr>
<td><strong>Unemployment Rate, in %⁴</strong></td>
<td>13.6</td>
<td>16.1</td>
<td>19.2</td>
<td>23.0</td>
<td>23.9</td>
<td>22.1</td>
<td>19.2</td>
<td>17.7</td>
<td>15.3</td>
<td>13.5</td>
<td>12.7</td>
<td>10.4</td>
<td>9.7</td>
<td>-</td>
</tr>
<tr>
<td><strong>Nominal Wages, in %⁵</strong></td>
<td>18.0</td>
<td>9.0</td>
<td>7.6</td>
<td>11.2</td>
<td>9.0</td>
<td>6.2</td>
<td>1.4</td>
<td>-0.2</td>
<td>3.7</td>
<td>3.9</td>
<td>6.5</td>
<td>10.6</td>
<td>9.0</td>
<td>-</td>
</tr>
<tr>
<td><strong>Money Supply (M3), in %</strong></td>
<td>9.8</td>
<td>21.5</td>
<td>12.9</td>
<td>10.3</td>
<td>9.4</td>
<td>4.6</td>
<td>7.6</td>
<td>6.6</td>
<td>11.6</td>
<td>3.6</td>
<td>14.5</td>
<td>8.4</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>CPI,² in %</strong></td>
<td>8.6</td>
<td>6.6</td>
<td>10.3</td>
<td>7.0</td>
<td>12.2</td>
<td>2.2</td>
<td>1.7</td>
<td>1.5</td>
<td>1.6</td>
<td>3.0</td>
<td>2.0</td>
<td>1.9</td>
<td>1.7</td>
<td>1.6</td>
</tr>
<tr>
<td><strong>National Bank of Serbia Key Policy Rate,³ in %</strong></td>
<td>17.8</td>
<td>9.5</td>
<td>11.5</td>
<td>9.8</td>
<td>9.5</td>
<td>8.0</td>
<td>4.5</td>
<td>4.0</td>
<td>3.5</td>
<td>3.0</td>
<td>2.25</td>
<td>1.25</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

¹ Excluding the effect of change in inventories
² Inflation figures in the table represent Dec on Dec inflation: (Pt/Pt-12)*100-100
³ Latest data
⁴ Labour Force Survey. Since 2014, data are revised according to the new LFS methodology. Data for Q1 2020.
⁵ Since 2017, nominal wages published according to the new methodology. January-May 2020 data

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**Nominal Wages, in %**

## Banking Sector Overview

<table>
<thead>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of banks</strong>&lt;sup&gt;1&lt;/sup&gt;</td>
<td>33</td>
<td>32</td>
<td>30</td>
<td>29</td>
<td>30</td>
<td>31</td>
<td>29</td>
<td>27</td>
<td>26</td>
<td>26</td>
</tr>
<tr>
<td><strong>Employees</strong></td>
<td>29,228</td>
<td>28,394</td>
<td>26,380</td>
<td>25,106</td>
<td>24,257</td>
<td>23,847</td>
<td>23,055</td>
<td>22,830</td>
<td>23,087</td>
<td>22,877</td>
</tr>
<tr>
<td><strong>Branches</strong></td>
<td>2,383</td>
<td>2,243</td>
<td>1,989</td>
<td>1,787</td>
<td>1,730</td>
<td>1,719</td>
<td>1,627</td>
<td>1,598</td>
<td>1,598</td>
<td>1,578</td>
</tr>
<tr>
<td><strong>HHI Assets</strong></td>
<td>664</td>
<td>678</td>
<td>741</td>
<td>794</td>
<td>796</td>
<td>813</td>
<td>813</td>
<td>779</td>
<td>800</td>
<td>800</td>
</tr>
<tr>
<td><strong>Share of foreign banks, %</strong></td>
<td>74.1</td>
<td>75.2</td>
<td>74.3</td>
<td>74.5</td>
<td>76.1</td>
<td>76.7</td>
<td>76.9</td>
<td>75.4</td>
<td>75.7</td>
<td>76.4</td>
</tr>
<tr>
<td><strong>Assets (net), EUR m</strong></td>
<td>25,211</td>
<td>25,322</td>
<td>24,827</td>
<td>24,545</td>
<td>25,059</td>
<td>26,253</td>
<td>28,440</td>
<td>31,931</td>
<td>34,731</td>
<td>37,390</td>
</tr>
<tr>
<td><strong>Capital, EUR m</strong></td>
<td>5,104</td>
<td>5,198</td>
<td>5,186</td>
<td>5,074</td>
<td>5,090</td>
<td>5,122</td>
<td>5,631</td>
<td>5,725</td>
<td>6,002</td>
<td>5,982</td>
</tr>
<tr>
<td><strong>Loans (gross), EUR m</strong></td>
<td>17,204</td>
<td>17,273</td>
<td>16,140</td>
<td>16,170</td>
<td>16,175</td>
<td>16,442</td>
<td>17,565</td>
<td>19,406</td>
<td>21,111</td>
<td>22,794</td>
</tr>
<tr>
<td><strong>Of which gross NPL, EUR m</strong></td>
<td>3,275</td>
<td>3,217</td>
<td>3,448</td>
<td>3,483</td>
<td>3,491</td>
<td>2,800</td>
<td>1,730</td>
<td>1,105</td>
<td>862</td>
<td>853</td>
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<tr>
<td><strong>Gross NPL ratio, %</strong></td>
<td>19.0</td>
<td>18.6</td>
<td>21.4</td>
<td>21.5</td>
<td>21.6</td>
<td>17.0</td>
<td>9.8</td>
<td>5.7</td>
<td>4.1</td>
<td>3.7</td>
</tr>
<tr>
<td><strong>IFRS impairment of NPLs</strong></td>
<td>51.0</td>
<td>50.0</td>
<td>50.9</td>
<td>54.9</td>
<td>62.3</td>
<td>67.8</td>
<td>58.1</td>
<td>60.2</td>
<td>61.5</td>
<td>62.6</td>
</tr>
<tr>
<td><strong>Deposits, EUR m</strong></td>
<td>14,584</td>
<td>14,936</td>
<td>15,067</td>
<td>15,637</td>
<td>16,523</td>
<td>18,242</td>
<td>19,926</td>
<td>23,115</td>
<td>25,197</td>
<td>27,477</td>
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<tr>
<td><strong>Pretax Income</strong>, EUR m</td>
<td>12.0</td>
<td>102.5</td>
<td>-18.0</td>
<td>29.0</td>
<td>80.0</td>
<td>172.0</td>
<td>579.8</td>
<td>640.6</td>
<td>575.5</td>
<td>251.9</td>
</tr>
<tr>
<td><strong>CAR&lt;sup&gt;3&lt;/sup&gt;, %&lt;sup&gt;2&lt;/sup&gt;</strong></td>
<td>19.1</td>
<td>19.9</td>
<td>20.9</td>
<td>20.0</td>
<td>20.9</td>
<td>21.8</td>
<td>22.6</td>
<td>22.3</td>
<td>23.4</td>
<td>22.7</td>
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<tr>
<td><strong>CET1 ratio %&lt;sup&gt;3,4&lt;/sup&gt;</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>21.5</td>
<td>21.1</td>
<td>22.3</td>
<td>21.8</td>
<td></td>
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<tr>
<td><strong>Leverage %&lt;sup&gt;3,4&lt;/sup&gt;</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>11.1</td>
<td>12.6</td>
<td>13.6</td>
<td>12.9</td>
</tr>
<tr>
<td><strong>Liquidity ratio</strong></td>
<td>2.2</td>
<td>2.1</td>
<td>2.4</td>
<td>2.2</td>
<td>2.1</td>
<td>2.1</td>
<td>2.0</td>
<td>2.0</td>
<td>2.2</td>
<td>2.2</td>
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<tr>
<td><strong>Liquidity coverage ratio&lt;sup&gt;4&lt;/sup&gt;</strong>, %</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>239.5</td>
<td>213.3</td>
<td>199.3</td>
<td>208.6</td>
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<tr>
<td><strong>FX ratio, %</strong></td>
<td>6.2</td>
<td>5.5</td>
<td>4.4</td>
<td>3.9</td>
<td>4.4</td>
<td>2.7</td>
<td>2.9</td>
<td>4.5</td>
<td>1.5</td>
<td>0.9</td>
</tr>
<tr>
<td><strong>ROA&lt;sup&gt;2&lt;/sup&gt;, %</strong></td>
<td>0.0</td>
<td>0.4</td>
<td>-0.1</td>
<td>0.1</td>
<td>0.3</td>
<td>0.7</td>
<td>2.1</td>
<td>2.1</td>
<td>1.7</td>
<td>1.4</td>
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<td><strong>ROE&lt;sup&gt;2&lt;/sup&gt;, %</strong></td>
<td>0.2</td>
<td>2.0</td>
<td>-0.4</td>
<td>0.6</td>
<td>1.6</td>
<td>3.4</td>
<td>10.6</td>
<td>11.3</td>
<td>9.8</td>
<td>8.4</td>
</tr>
<tr>
<td><strong>Net interest margin&lt;sup&gt;5&lt;/sup&gt;, %</strong></td>
<td>4.6</td>
<td>4.3</td>
<td>4.2</td>
<td>4.3</td>
<td>4.3</td>
<td>3.9</td>
<td>3.7</td>
<td>3.6</td>
<td>3.3</td>
<td>3.0</td>
</tr>
</tbody>
</table>

<sup>1</sup> The NBS revoked operating licence from Nova Agrobanka on 27 October 2012, from Razvojna banka Vojvodine on 6 April 2013, from Privredna banka Beograd on 26 October 2013, from Univerzal banka Beograd on 31 January 2014 and from Jugobank Jugbank Kosovska Mitrovica on 2 April 2018. The NBS issued operating licence to Mirabank on 16 December 2014 and the bank started its operations in April 2015. The NBS issued operating licence to Bank of China Srbija on 20 December 2016. The Findomestic bank was merged to Direktna bank on 1 July, 2017. Jubanka ad Beograd was merged to AIK bank on 23 December, 2017. Pireaus bank was merged to Direktna bank on 26 October, 2018. Vojvođanska bank was merged to OTP bank 25. April 2019 (consolidated under Vojvođanska brand).

<sup>2</sup> Without Agrobanka at the end of 2011: Pretax profit € 296m; ROA 1.2; ROE 6.0. Without Razvojna banka Vojvodina at the end of 2012: Pretax profit € 230m; ROA 1.0; ROE 4.7

<sup>3</sup> The last available data of 30.06.2020

<sup>4</sup> Introduced by the implementation of Basel 3 and monitored from 30 June 2017

<sup>5</sup> Net interest margin to average total asset